

# **Report of the Water Company Acquisition Study Committee**

**Annual Town Meeting, April 22, 2013**

## **Report Objective**

The objective of this report, approved in public session by the Water Company Acquisition Study Committee, is to update Town citizens regarding the background, process, current status, and next steps associated with the study authorized by Annual Town Meeting 2012.

In accordance with the approved affirmative motion for Article 19 of Annual Town Meeting 2012, the Committee has been exploring the feasibility and advisability of the Town exercising its right under Chapter 139 of the Acts of 1879 passed by the General Court of Massachusetts—which first formed the water company—to acquire the corporate property, rights, and privileges of the water company, which is now part of the *Aquarion Water Company of Massachusetts, Inc.*

## **Water Company History**

Contrary to commonly-held belief, the Town has never actually owned the water company. In fact, Town Meetings from 1875 through 1878 voted against motions for the Town to bear the cost “to supply the Town of Hingham with pure water.” Consequently, a privately-owned company, the *Hingham Water Company*, was formed by the Acts of 1879, the initial equity of which was held by approximately fifty-four shareholders, most of whom were Hingham residents.

Construction of the water distribution system was begun on Otis Street in front of the residence of Honorable John D. Long, a stockholder and then Lieutenant-Governor of the State. Filling of the pipes from Accord Pond was essentially complete on June 30<sup>th</sup>, 1880. In accordance with subsequent acts of the legislature in 1881 and 1924, water company pipes were extended to Hull, north Cohasset, and a portion of Norwell.

Since the formation of the water company, the Town has periodically investigated whether and how it might exercise its right under the 1879 charter to purchase the water company—studies motivated by concerns regarding high water rates, poor water quality, and inadequate system infrastructure. The most recent Town-authorized study—conducted in 1984-1985 by two consulting firms on behalf of the Water Supply Committee—concluded that savings from Town construction of a treatment plant and ownership of both the plant and transmission/distribution system were not substantial enough “to offset the difficulties and uncertainties” of buying the company and running a municipal water district.

More recently, foreign companies have begun to make investments in essential U.S. infrastructure assets. In 2001, Kelda Group PLC, a British firm, bought the American Water Works companies in New England—which included the water company serving the Town—and formed the *Aquarion Water Company*, headquartered in Bridgeport, CT. The *Aquarion Water Company* serves 212,346 customers through three subsidiaries incorporated, respectively, in Connecticut, New Hampshire, and Massachusetts. The *Aquarion Water Company of Massachusetts* consists of two separate operations: *Service Area A*, serving 12,740 customers in Hingham, Hull, and Cohasset, and *Service Area B*, serving 6,220 customers in Oxford and

Millbury. In 2006, an investment entity of Australia's Macquarie Bank, Macquarie Essential Assets Partnership, acquired the rights to the *Aquarion Company*; it has since sold a roughly 46% interest in the company to British Columbia Investment Management, a fund manager for public-sector clients in British Columbia.

The latest *Annual Report of the Aquarion Water Company of Massachusetts*, filed with the Department of Public Utilities (DPU) in April 2012, documents that 7,835 customers, or 61.5% of the *Service Area A* customer set, are supplied water in Hingham; 4,580 customers, or 35.9% of the customer set, in Hull; and, 325 customers, or 2.6% of the customer set, in Cohasset. Water is sourced primarily from 12 wells and two ponds located in Hingham and is distributed through roughly 191 miles of pipes of various diameters. Approximately 14% of Hingham's pipes are of pre-1920 vintage, while 46% of Hull's distribution system was installed prior to 1920. In spite of limited infrastructure in Norwell, the company does not currently serve customers in Norwell. According to the Hingham Board of Health *Well Registry*, approximately 283 Hingham locations source drinking water from domestic wells and, therefore, are not served by the company.

In its May 2011 rate-increase petition to the DPU, the company represented its annual Total Cost of Service to be roughly \$16.5M. *Service Area A* operating revenues constitute approximately  $\frac{3}{4}$  of that amount, \$12.4M, including water treatment plant charges borne solely by *Service Area A* customers. The company employs fourteen employees to support *Service Area A*.

## **Study Background**

Article 19 of the *Warrant for Annual Town Meeting 2012* initially recommended authorization of \$500,000 to be used by the Board of Selectmen for investigation into the feasibility of acquisition of the Town's water company under Section 11 Chapter 139 of the Acts of 1879, or through negotiation or litigation.

Town Meeting discussion of Article 19 focused primarily on four main considerations: rates, operating costs, infrastructure, and water supply.

### Rates

At the time of Town Meeting 2012, Hingham (*Service Area A*) had the 5<sup>th</sup> highest water rates in the Commonwealth, reflecting a nearly 21% rate increase granted by the DPU in 2009. A subsequent rate-increase petition had already been filed in 2011 by Aquarion, requesting an 18.7% increase to become effective in 2012. Aquarion's 2011 rate-increase filing signaled its announced policy to file rate cases every three years.

### Operating Costs

As a privately-held company, Aquarion exists to deliver returns to its investors over and above its actual operating, maintenance, and debt-service costs. Likewise, Aquarion cited diminished investment returns, litigation costs in *Service Area B*, and pension fund losses as factors justifying its 2011 18.7% rate-increase filing.

### Infrastructure

Aquarion's capital resource limitations were perceived to be the cause of deferred upgrading of a water main which had broken six times during the preceding year or so. This

perception was not dispelled by Aquarion during a December 2011 Board of Selectmen hearing on the matter in response to persistent citizen complaints.

### Water Supply

While the Massachusetts Department of Environmental Protection (DEP) regulates the quantity of water withdrawn from all the Commonwealth's water supplies, Aquarion is delegated the sole distribution rights and decision-making authority within its area of responsibility.

### Summary

Town Meeting proponents of Article 19 argued that Town ownership of the water company would obviate the need to generate profit for shareholders and might also enable lower borrowing costs than those available to the company. Both factors might facilitate lower and slower rate increases than those experienced under company ownership since Macquarie's 2006 acquisition. Likewise, acknowledging that any capital improvement costs would ultimately be passed along to rate-payers—regardless of ownership—proponents felt that capital allocation would not be influenced by investment-return considerations with Town ownership. Finally, proponents felt that the Town should have a more substantive role in setting and administering policies associated with conservation of such an increasingly critical resource as water.

Opponents of Article 19 expressed a number of concerns with the potential expenditure of \$500,000 in the absence of any estimate of potential rate savings that ratepayers might secure through acquisition of the water company. There were also concerns that any study might not be well handled, and that a recommendation to acquire the water company would likely require more funding than requested and more time than available to comply with Annual Town Meeting 2013 article-submission deadlines. Finally, were the Town to litigate and lose, it would have nothing to show for monies expended, and Aquarion would likely attempt to recover its own litigation costs in its next rate-increase filing with the DPU.

Article 19 was approved after the original recommended motion requesting a \$500,000 authorization was amended to \$320,000. The Board of Selectmen subsequently completed appointments to the Water Company Acquisition Study Committee (the 'Committee') in May 2012, and the Committee conducted its inaugural meeting on May 30<sup>th</sup> 2012.

### **Study Process**

At its first meeting, the Committee unanimously voted to adopt *Principles of Operation* for the conduct of Committee affairs, foremost among which was that:

“Committee members shall conduct and supervise the study in a fair and open-minded fashion with no predisposition towards any particular outcome or result.”

In accordance with Town Meeting discussion, the Committee has worked to conduct the study serially in three phases: financial, engineering, and governance, the primary rationale for which was to expend as little as possible of Town-authorized funding. To wit, if an insurmountable issue (a 'showstopper') were identified during any phase, time and money would not be expended on the performance of subsequent phases.

In an effort to conduct its work in an open and accessible manner, the Committee established pages on the Town's web site containing meeting minutes, presentations, and hundreds of pages of documents the Committee has utilized in conducting its investigations. Those materials may be accessed through the internet at:

[http://www.hingham-ma.com/Committees/Water\\_Company/index.html](http://www.hingham-ma.com/Committees/Water_Company/index.html).

On July 2<sup>nd</sup> 2012, the water company delivered to the Town the detailed financial documentation which it had promised during Town Meeting. Company officials subsequently presented three acquisition-cost options—in accordance with the company's interpretation of the 1879 charter—at a public meeting in Sanborn Auditorium on July 11<sup>th</sup> 2012. Including acquisition of the Water Treatment Plant placed into service in 1996, those options ranged in price from roughly \$145M to \$194M.

The Committee's preliminary financial analysis prior to the company's July 2012 presentation and its more detailed study through year-end 2012, utilizing the company-provided information, have focused primarily on operating and maintenance cost reductions—and additions—resulting from Town acquisition. That analysis was aided by three 'financial reconciliation' meetings between the Town and company officials between August and October 2012. The Committee also availed itself of counsel from industry and financial experts, both from within the ranks of Town volunteers as well as by paid consultants.

Since October, the Committee has shifted its financial analysis to determination of the water company purchase price, analyzing alternative interpretations of the 1879 charter formula from those presented by company officials in July 2012 as well as fair market valuation under eminent domain.

While the primary focus of the Committee during the past year has been financial analysis, the Committee also conducted summary 'look-aheads' at engineering and governance in August 2012 to determine if obvious 'show-stoppers' existed which would merit early termination of the study. In addition, a meeting was held with the Town Managers of Hull and Cohasset to discuss the rationale for the study and to explore possible approaches to governance. Likewise, discussions were initiated with the firm to which the Cohasset Water Department—serving the majority of Cohasset's residents—has outsourced operations and maintenance responsibility. That discussion of engineering considerations provided the Committee a better understanding of options for ongoing management of the water company should an acquisition by the Town occur.

Concurrent with the Committee's ongoing analysis, executive discussions between the Town—represented by the Board of Selectmen liaison, the Town Administrator, and the Committee Chair—and Macquarie and Aquarion senior management have occurred five times since August 2012 in order to facilitate study progress and to provide a forum for any potential negotiation discussions.

## **Current Status**

### **Rates**

In early October, the company announced that it was refinancing the Water Treatment Plant's debt, and that savings from the refinancing would be passed along to *Service Area A* customers in the form of an 8.2% rate reduction. The company estimated that savings would result in a \$926,000/year decrease in the water treatment plant surcharge that appears on all

Service Area A water bills. Those savings were applied by the company to ratepayer bills starting in November 2012.

### Infrastructure

The Union Street water main was upgraded more than one year earlier than originally communicated to the Board of Selectmen. Likewise, the company's new Vice President has improved coordination and communication with the Town Projects Engineer with the objective of scheduling future water company infrastructure upgrades to coincide, where possible, with Town road repairs.

Finally, the status of citizen customer-service complaints brought to the attention of the Town Administrator is now reviewed in quarterly meetings between the Town Administrator and the company Vice President.

### Study Expense

Through February 2013, the Committee has expended \$84,508 of the \$320,000 authorized.

### Summary

Both the Committee's financial analysis as well as its discussions with the outsourcing firm which operates the Cohasset Water Department under contract to the Town of Cohasset support the position that were the Town to acquire the water company, ongoing operating and maintenance costs would be at least 'rate transparent,' *i.e.*, rates associated with operations and maintenance costs would not be higher initially as a result of the acquisition.

The company's current annual 'budget' for capital improvement is approximately \$1.4M. The Committee believes that upgrade of the water company infrastructure may need to be accelerated, with the objective of decreasing the frequency and severity of continuing service disruptions. Consequently, any recommendation by the Committee to acquire the water company would likely entail creation of a capital reserve to enable a period of system-upgrade expenditures greater than \$1.4M per year.

Ultimately, a recommendation by the Committee to acquire the water company hinges upon interpretation of the 1879 statute pricing formula in a manner which is both supported by the law and which could withstand challenge were the company to dispute the Town's position in court. In their most recent executive discussion with the Town, Aquarion executives have reaffirmed that they want to continue to own the company and that it is not for sale.

The purchase price numbers released by the water company in July 2012 would seem high for the purchase of a regulated company with current annual revenues of approximately \$16.5M and 14 employees, however, the Committee continues to evaluate the potential purchase price in conjunction with the 1879 statute. Any acquisition recommendation by the Committee would be based on financial projections which accommodate the criteria for ratepayer 'rate transparency,' the creation of a capital reserve large enough to accelerate infrastructure upgrade, and funding for estimated legal expenditures sufficient to address possible legal action.

As of the Committee's latest meeting in April 2013, no final decision regarding a recommendation to acquire the water company has been made.

**Next Steps**

The Committee continues to investigate options under the 1879 statute pricing formula and the court cases which would support those options. The Committee expects to complete the investigation of statutory pricing options during the next month or so. Should a financially sound and defensible pricing option be identified, the Committee is prepared to address engineering and governance issues in an expeditious manner.

Absent unforeseen developments, the Committee hopes to complete its work during the summer of 2013. Were the Committee to make a recommendation to acquire the water company, its current position is that such a significant discussion would best be served by scheduling a Special Town Meeting.

**Water Company Acquisition Study Committee**

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Joseph L. Bierwirth  
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